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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 173.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SAMUEL A. SALVAGE,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOHN G. JACKSON,
Solicitor for Respondent.

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The above named respondent submits that the prayer of the Commissioner for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit should not be granted.

Opinions Below.

The opinion of the Board of Tax Appeals (R., 49-56) is unreported. The opinion of the Circuit Court of Appeals (R., 135) is reported in 76 F. (2d) 112.

Jurisdiction.

The judgment of the Circuit Court of Appeals reversing the decision of the Board of Tax Appeals in part and affirming it in part was entered on March 25, 1935 (R., 140). The jurisdiction of this court is invoked under Section 240-a of the Judicial Code (as amended by the Act of February 13, 1925).

Question Presented.

The taxpayer on December 30, 1922, purchased stock pursuant to the contract in evidence and simultaneously exchanged it for preferred and common stock of the holding company. In his return for the year 1922 he did not report as income any difference between the price paid and the real value of the stock (as subsequently found). This was due to an innocent mistake of law (R., 138). T. D. 3435, the first statement of the so-called "bargain purchase" rule, was not issued until February 1923. The selling corporation did not in its 1922 income tax return deduct any amount representing such difference in value as an expense of business (R., 76).

Upon the filing of taxpayer's 1929 return the Statute of Limitations had run against claims based upon the year 1922.

In his 1929 return the taxpayer reported as income the difference between the amount paid by him for the stock and the amount received upon the redemption of the preferred stock. He relied on Article 1567, Regulations 62, to the effect that where two classes of stock are received in exchange for one class *and no fair apportionment is practicable* (our italics) no profit is realized until the entire cost is recovered.

The transaction is summarized as follows (R. 136):

Paid for 1500 shares Viscose Company 1922		*Received for 1500 shares Viscose Company 1922*
$150,000		6000 shares Amer. Viscose pfd.
		7500 " " " common

Received for 7500 shares American Viscose pfd. 1929	*Returned as taxable gain 1929*
$660,000	$510,000

leaving the taxpayer possessed of 7500 shares of the common stock the entire proceeds of which would be subject to tax.

The Commissioner held this theory incorrect, found a valuation, made an apportionment, and assessed a deficiency.

In his petition to the Board the taxpayer took the position:

(1) That the theory of his return was correct, that no valuation or apportionment was practicable, and no deficiency should have been assessed.

(2) If the Commissioner was correct and a valuation and apportionment was practicable, then the difference in value represented compensation under the contract and he was entitled to a refund (R., 53).

Both the Board and the Circuit Court sustained the Commissioner upon the question of value and apportionment and the Circuit Court sustained the taxpayer in part on the claim for refund.

The Commissioner did not plead estoppel nor is it referred to in the Board's opinion. It was first urged by him before the Circuit Court.

The question presented is whether under the above circumstances the taxpayer is estopped from claiming that he received as income in the year 1922 and as compensation under the contract in evidence the difference between the amount paid by him in cash for the stock and its value as found by the court.

Statement.

The statement of facts in the petition is accurate except as to the statement on page 5 thereof that the theory of the taxpayer was that the difference between the cost of the stock and the fair market value represented compensation for services. Assignment of error (d) (R., 4-5) states that such difference was additional compensation to him *pursuant to contract* (our italics). Paragraph V-(a) (R., 5-6) states the substance of the contract and a copy thereof was annexed to the petition (R., 19-21). The question of whether such compensation was received for services rendered or to be rendered, or for refraining from comptition,

was to be determined from the contract itself and the relevant surrounding circumstances. At no time did the taxpayer confine his claim to the former.

Argument.

The Commissioner specified that the Circuit Court erred:

In failing to hold that the taxpayer was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock acquired in 1922, by his failure to report the difference between the cost and fair market value as income for 1922.

He presents the following arguments in support of his contention that the writ should be allowed:

(1) That all of the elements required to establish equitable estoppel or estoppel *in pais* exist in this case.

(2) The decision of the court below is directly opposed to decisions of the Circuit Courts of other circuits and of this Court.

(3) That the failure to plead estoppel did not preclude its consideration by the court.

POINT I.

The necessary elements of estoppel did not exist in this case.

The elements necessary to sustain a claim of estoppel in an income tax case are correctly set forth in *U. S.* v. *S. F. Scott & Sons*, 69 F. (2d) 728, 732, as follows:

> "(1) There must be a false representation or wrongful misleading silence.
>
> (2) The error must originate in a statement of fact and not in an opinion or in a statement of law.
>
> (3) The person claiming the benefits of estoppel must be ignorant of the true facts.

(4) He must be adversely affected by the acts or statements of the person against whom an estoppel is claimed."

The tests laid down in that case are not met in the instant case for (1) the silence was in no sense wrongful, (2) it was based upon an erroneous opinion as to the law (R., 138), and (3) there is nothing in the record to show that petitioner or his predecessors were adversely affected.

In the case of *The Viscose Company*, 3 B. T. A. 444, the Board had held it impossible to determine the value of the assets of the company.

While it is true that the taxpayer did not return the additional income as such, there is nothing to show a loss of tax thereby. Petitioner did not put the 1922 return of the taxpayer in evidence, although he might have done so. The record (R., 76) also shows that The Viscose Company did not deduct the amount in controversy as salary in its return. Had it done so the Treasury would presumably have been deprived of 12½% of the amount. To sustain petitioner's claim might result not in preventing the Treasury from obtaining taxes which should have been paid to it, but in allowing it to be unjustly enriched. If the 1922 liability was not correctly determined, this is no reason to seek to correct the error by an erroneous determination for a subsequent year. *Swiss Oil Co.*, 32 B. T. A., June 14, 1935. There is no evidence that the Commissioner relied on the 1922 return.

The only one of the cases relied on by petitioner to sustain his contention that all the elements of estoppel exist in this case which might be considered in point is *Stearns Co.* v. *U. S.* 291 U. S. 54. That case is clearly distinguishable. It involved a deliberate affirmative request by the taxpayer to the Commissioner to withhold collection, which request the Commissioner granted. After the statute had run the taxpayer endeavored to take advantage of the statute. The court held he was estopped from so doing.

The instant case involves no such affirmative act nor any such misleading of the Commissioner.

A distinction which must be emphasized and should be observed in connection with all of the Commissioner's arguments is the following:

The taxpayer filed a return in good faith basing his tax upon what he believed to be the law (R. 138). The theory adopted by him would eventually have given the Government a tax upon the full difference between the cost of $100. per share and the total proceeds. The Commissioner rejected this theory. The taxpayer was defeated in his contention and the Commissioner sustained. The taxpayer now merely seeks to carry the Commissioner's theory, which he has been forced to adopt, to its logical conclusion. If any detriment to the Government has arisen, it arises not from any position deliberately taken by the taxpayer but from its own action.

POINT II.

No conflict is shown between the decision in this case and decisions in other Circuits or in this Court.

The basis of claim for the writ is that the decision of the Circuit Court is directly opposed to decisions in other circuits, principally *Crane* v. *Commissioner,* 68 F. (2d) 640, *Bothwell* v. *Commissioner,* (C. C. A. 10) 1935 C. C. H. Vol. 3, Par. 9302, and *Edward G. Swartz Inc.* v. *Commissioner,* 69 F. (2d) 633.

In the *Crane* case an examination of the record, the Circuit Court decision, and the decision of the Board of Tax Appeals, 27 B. T. A. 360, shows that estoppel was not mentioned at any time (this despite the statement at the bottom of page 15 of the petitioner's brief). Certain language in the majority opinion might be construed as holding that estoppel applied, but the language is equally consistent

with the theory of election. The case of *U. S.* v. *S. F. Scott & Sons, supra,* which stated the principles upon which estoppel is based, is entirely consistent with the instant case and was decided by the First Circuit. No conflict, therefore, exists between the two jurisdictions.

The *Bothwell* case is distinguishable in several respects:

(1) Estoppel was pleaded, while it was not here.

(2) It is not apparent whether an error in the return in respect to compensation for services originated in a statement of fact or an opinion of law. Here the error was clearly one of law.

(3) The court held that compensation had not in fact been received, hence the language in respect to estoppel was unnecessary to the decision. Here the court held compensation had been so received.

(4) The statute ran during the pendency of the proceeding. If at its commencement the taxpayer had set forth the claim as finally made, the Commissioner would have been in a position to protect himself. Here the statute had run before the controversy arose.

In the *Swartz* case, entirely aside from differences in the facts, the court stated that it was unnecessary to consider the question of estoppel and its language in respect to it was clearly dictum.

The other cases relied on by the Commissioner but not analyzed are distinguishable in respect to the act of the taxpayer which prevented the collection of tax before the statute ran.

In *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776, *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320 and *Giant Furniture Co.* v. *U. S.,* 9 F. Supp. 585, there had been affirmative claims for deductions in previous returns, which claims had been allowed, and the taxpayers sought, after the statute had run, to claim that such deductions in

such years were improper and should be attributed to subsequent years. *Newaygo Co.* v. *Helvering,* 1935 C. C. H. Vol. 3, Par. 9320, involves the same principle.

In *Naumkeag Steam Cotton Co.* v. *U. S.,* 2 F. Supp. 126 and *Stearns Co.* v. *U. S., supra,* there were affirmative requests by the taxpayers which induced Commissioner to withhold collection until after the statute had run.

In *Adler* v. *Commissioner,* C. C. A. 5th, 1935 C. C. H. Vol. 3, Par. 9397, the taxpayer included the amount in controversy as income in his return for a certain year and after the statute had run against a previous year amended and claimed that it had been received in such previous year.

In *Mahoning Investment Co.* v. *U. S.,* 3 F. Supp. 622, the parent company, with full knowledge of the facts, paid a tax which had been erroneously assessed against it instead of properly against a subsidiary, and after the statute had run sought a refund.

In each instance there was an affirmative representation upon which the Commissioner relied.

POINT III.

The Commissioner cannot claim the benefit of estoppel as he did not plead the same.

The Board has power to prescribe its rules of practice and procedure. Section 907-(a) Revenue Act of 1924, as amended by Section 1000, Revenue Act of 1926 and Section 601 of the Revenue Act of 1928. Rule 14 of the Board requires the Commissioner to file an answer which shall contain

> "A specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commission relies for defense or for affirmative relief, or to sustain any issue raised in the petition in respect of which issue the burden of proof is by statute placed on the Commission."

The Board in a recent decision held that estoppel must be pleaded and proven. *Swiss Oil Co.* v. *Commissioner, supra.* This was also held in *Helvering* v. *Brooklyn City Ry. Co.*, 72 F. (2d) 274. The Commissioner's statement in the last sentence of the footnote at page 15 of the petition that both the Board and the Circuit Court considered the question of estoppel in the *Crane* case, *supra,* is not supported by the record. The Board dealt with the case on a theory that the taxpayer had not met the burden of proof, and its opinion makes no mention of estoppel. The opinion of the Circuit Court does not use the word "estoppel" and is consistent with a decision on the basis of election. The cases relied on by the Commissioner are not in point.

Board of Tax Appeals v. *U. S. ex rel. Schuts Bread Co.*, 37 F. (2d) 442, dealt with a construction of Rule 20 of the Board which has no analogy to Rule 14.

Greengard v. *Commissioner*, 29 F. (2d) 502, related to the verification of an answer by the Commissioner and the Court held such verification was not required.

Hanby v. *Commissioner*, 67 F. (2d) 125, dealt with the same rule but was decided prior to the amendment by which the rule was put in its present form.

The inference, if any, to be drawn from all of these cases is that the rules will be strictly interpreted.

Nor is the Commissioner's claim that he had no reason or opportunity to plead estoppel sound. His statement in the first sentence of footnote 5, on page 13 of the petition, is not in accord with the facts. Paragraph IV-(d) (R. 4) of the petition specifically claims error in not holding that the difference in value was compensation to the taxpayer under the contract. It does not say compensation to the taxpayer for services. The contract was not to compete and was summarized (R. 6) and annexed as an exhibit (R. 19-21). No change was made in this allegation throughout. It was met by a general denial. The claim was clear and specific and if the Commissioner intended to claim estoppel he was required by Rule 14 to set it up in his answer.

CONCLUSIONS.

The writ should not be allowed because

1. The elements necessary to establish estoppel are not present.

2. There is no conflict of decision.

3. Failure to plead the estoppel bars the claim.

4. No question of public importance is involved.

JOHN G. JACKSON,
Solicitor for Respondent.

August, 1935.